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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

No. 662

ROSE KIMEN,

Petitioner,

vs.

ATLAS EXCHANGE NATIONAL BANK OF CHICAGO, a corporation,

Respondent.

ON WRIT OF CERTIORARI.

BRIEF FOR RESPONDENT.

IMPLIED ASSUMPSIT.

A.

The repurchase agreement was against public policy and prohibited by statute, of which plaintiff was chargeable with notice. The courts will not give assistance to either party to such transactions but will leave them where it finds them.

Petitioner's specifications of error do not question the correctness of the holding by the Appellate Court of Illinois

that the repurchase agreement "is beyond the powers of defendant bank to make *and is void upon the ground of public policy*" (R. 79), but on the contrary they accept without objection the finding and holding of that court that the repurchase agreement is *ultra vires* and void under the National Bank Act and assign error only on the refusal of that court to permit recovery on an implied assumpsit.

In considering this question of the right of recovery on an implied assumpsit, it becomes necessary to determine the reason for the invalidity of the contract. If the repurchase agreement was in disobedience of some positive provision of law or against public policy, the law would not give any assistance to the parties, either on the express contract or on an implied one.

The Appellate Court of Illinois very clearly based its decision, of the invalidity of the repurchase agreement, upon the fact that it was contrary to public policy and in violation of the National Bank Act. It was provided by an amendment of that act made in 1927 that the business of the bank in buying and selling investment securities,

> "Shall hereafter be limited to buying and selling without recourse marketable obligations,"

and it was held by the court that there was a violation of this provision, when the bank in connection with the sale of the bonds involved, entered into the repurchase agreement obligating itself to buy back at maturity the bonds at par and accrued interest if the purchaser should then so desire.

The Appellate Court of Illinois in coming to this conclusion, followed the decision of the Supreme Court of Illinois in the recent case of *Knass* v. *Madison and Kedzie Bank*, 354 Ill. 554. The Supreme Court of Illinois, in that case, had before it for determination the question of the

validity of repurchase agreements given by a state bank in connection with the sale by the bank of real estate mortgage bonds.

The court there held that the repurchase agreements amounted to a guaranty of the bonds and was not a power granted by the statute under which the bank was organized but was contrary to the express provisions of an act for the protection of bank depositors which provided that it should not be lawful for banks to assume the payment of, or guaranty the payment of, notes, bonds or other evidence of indebtedness of any person, company or incorporation. The court further held that these repurchase agreements created a contingent liability which could not be measured and determined in prospect or accurately reported to public officers whose duty it was to ascertain the condition of the bank; that a shrinkage in the value of the bonds might destroy the safety of deposits and trust funds and cause the entire destruction of the banking institution itself; that these repurchase agreements, because of their tendency to injure the public and destroy the well-being of banks, which are quasi-public institutions, were against public policy; and that these contracts being against public policy and prohibited by law can in no manner be enforced as the law does not prohibit and also enforce a contract.

The only difference between the "Knass" case and the case at bar lies in the fact that the Knass case involved a State bank and State statutes, while the case at bar involved a national bank and Federal Statutes. The powers granted in both cases are substantially the same. The public policy of the state and of the nation as indicated by the acts of the State legislature and of Congress are the same and the reasons for giving protection to the public and to national banks as agencies of the government are equally as strong

as those requiring protection to the public and State banks as quasi public institutions.

Repurchase agreements such as are here involved were held to be against public policy in *Greene* v. *First National Bank*, 172 Minn. 310. In that case the court said:

> "But a guaranty of commercial paper sold by a bank and a contract to repurchase real estate mortgages which the bank has sold stand on a different footing. As was said in *Eberlein* v. *Stockyards Mortg. & T. Co., supra*, to agree to repurchase on demand, and at face value securities the bank sells subjects it to a contingent liability, the sudden maturing of which, by the concurring demands of a large number of purchasers, may easily absorb its capital instantaneously. Paraphrasing the language of *Farmers' & M. Sav. Bank* v. *Crookston State Bank, supra*, it may be said that every bank is charged with duties to the public. A bank is more than a mere private corporation for pecuniary profit. A national bank is under the supervision of the federal authorities. A contract to repurchase real estate mortgages which the bank has sold is in defiance of safe banking, tends to injure the depositors of the bank, and is contrary to public policy."

The cases to which reference is made in the above quotation are reported as follows:

> *Eberlein* v. *Stockyards Mortgage and Trust Co.*, 164 Minn. 323.
>
> *Farmers & M. Savings Bank* v. *Crookston Bank*, 169 Minn. 249.

It thus appears that the repurchase agreement in question is against public policy and illegal both because of its tendency to injure the public as well as because of the specific statutory prohibition against it.

Under these circumstances it is the policy of the courts to render no assistance to either party in connection with such transactions but to leave them where it finds them.

Such contracts are, as is said in the "Knass" case, *"generally unenforceable by any remedy."*

In *Norbeck & Nicholson Company* v. *State of South Dakota,* 32 S. D. 189, the Court at page 198, says:

> "Illegality of contract, arising from express prohibition of law based on public policy, renders the contract wholly null and void for any purpose, and precludes a recovery on an implied contract or on the *quantum meruit;* otherwise a means would be thereby furnished for the undoing of the law itself."

And further says:

> "The general rule is that illegal contracts—illegal by reason of being expressly prohibited by law—are unenforceable, and no one can acquire any legal right under such a contract. If one of the parties has performed in whole or in part he cannot avoid the contract and recover from the adversary party a reasonable compensation for such performance. No right, therefore, arises out of an illegal transaction even on the theory of constructive contracts. The law leaves the parties to illegal contracts where it finds them, and gives them no assistance in extricating themselves from the situation in which they have placed themselves—no recovery can be had for services rendered thereunder, either on the express contract, or on an implied contract, or on *quantum meruit.*"

In *Gibbs* v. *Baltimore Gas Co.,* 130 U. S. 396, the Court at page 412, says:

> "The question is not one involving want of authority to contract on account of irregularity of organization or lack of affirmative grant of power in the charter of a corporation, but a question of the absolute want of power to do that which is inhibited by statute, and, if atempted, is in positive terms declared 'utterly null and void.'
>
> 'The rule of law,' said Parker, C. J., in *Russell* v. *DeGrand,* 15 Mass. 35, 39, 'is of universal operation,

that none shall, by the aid of a court of justice, obtain the fruits of an unlawful bargain.'

We cannot assist the plaintiff to get payment for efforts to accomplish what the law declared should not be done, and the judgment must be affirmed."

In *M. Hunter* v. *Pearl L. Wheate*, 31 A. L. R. 980 (289 Fed. 604), the Court at pages 982 and 983, says:

"It has long been the law that, where an action is founded upon an unlawful contract, the court will not interfere to relieve either of the parties thereto, in an action against the other, from the results thereof. In *Higgins* v. *McCrea*, 116 U. S. 671, 29 L. ed. 764, 6 Sup. Ct. Rep. 557, it was said: 'No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act.' If from the plaintiff's own stating, or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes, not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So, if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it.'

This was quoted from an earlier case. The authorities in support of this proposition are numerous, and only a few are referred to: *McMullen* v. *Hoffman*, 174 U. S. 639, 43 L. ed. 1117, 19 Sup. Ct. Rep. 839; *Continental Wall Paper Co.* v. *Louis Voight & Sons Co.*, 212 U. S. 227, 53 L. ed. 486, 29 Sup. Ct. Rep. 280; 1 C. J. 958.

This rule applies, whether the act is performed in the execution of a contract or not. In other words, it applies to transactions as well as to contracts, and hence the suggestion of appellee that the recovery here was upon the second count in the declaration as for a tort, regardless of the contract, is of no avail. If the act out of which the cause of action arisis is immoral or illegal, the courts will not grant relief.

The Florida, 101 U. S. 37, 25 L. Ed. 898; *Riggs* v. *Palmer*, 115 N. Y. 506, 5 L. R. A. 340, 12 Am. St. Rep. 819, 22 N. E. 188; *Levy* v. *Kansas City*, 22 L. R. A. (N. S.) 862, 93 C. C. A. 523, 168 Fed. 524. In the last-cited case, opinion by Sanborn, J., the authorities are exhaustively examined. It was said: 'But the maintenance of actions to recover moneys or property lost, or damages sustained, through transactions or contracts wherein the plaintiffs were guilty of moral turpitude, or of the violation of a general law passed to effectuate a public policy, is prohibited by this rule, as well as the maintenance of actions upon contracts of that nature.'"

In *Charles W. Flack, et al.* v. *John S. Warner, et al.*, 278 Ill. 368, the Court at page 375, says:

"This is a chancery proceeding. 'In general, where parties are concerned in illegal agreements or other transactions, whether they are *mala prohibita* or *mala In se*, courts of equity, following the rule of law as to participators in a common crime, will not, at present, interpose to grant any relief.' (*Miller* v. *Marckle*, *supra*, p. 154.) 'It is a principle of equity that where a contract is illegal, immoral or against public policy, or has been entered into through fraud or to accomplish any fraudulent purpose, a court of equity will not, at the suit of one of the parties, a *particeps doli*, while the agreement is still executory, either compel its execution or decree its cancellation, nor, after it has been executed, set it aside, and thus restore the plaintiff to the property or other interest which he has fraudulently or illegally transferred. Equity will leave such parties exactly in the position in which they have placed themselves, refusing all affirmative aid to any of the participants."

In *Ernest J. Seitz* v. *Theodore Michel* (Minn. Supreme Ct.), 181 N. W. 102, 12 A. L. R. 1060, the Court at page 1067, says:

"A court will not directly enforce a contract or recognize it by awarding damages for its breach if it

is contrary to public policy, but will leave the parties where it finds them, not out of consideration for the rights of either, but because the contract is injurious to or contravenes some interest of society or of the state. *Adams* v. *Adams*, 25 Minn. 72; *Peterson* v. *Christenson*, 26 Minn. 377, 4 N. W. 623; *Boyle* v. *Adams*, 50 Minn. 255, 17 L. R. A. 96, 52 N. W. 860; *Holland* v. *Sheehan*, 108 Minn. 362, 23 L. R. A. (N. S.) 510, 122 N. W. 1, 17 Ann. Cas. 687; *Buck* v. *Walker*, 115 Minn. 239, 132 N. W. 205, Ann. Cas. 1912D, 882; Dunnell's Dig. 1885."

Cases cited by petitioner do not involve transactions which were violative of public policy and specifically prohibited by law. They are based upon unjust enrichment arising from acts which while *ultra vires* were not of a nature injurious to the public. However, there is in this record no evidence of benefits received by the defendant growing out of the *ultra vires* agreement.

In the trial of this case the plaintiff offered no evidence of the amount of any benefit accruing to the bank from the sale of the bonds. The bonds were not the obligations of the bank, they were the obligations of another corporation, "The First National Company,' 'and the only benefit the defendant bank could have gained was any sum in the nature of a commission or profit for handling the bonds. If the bonds had been the obligation of the bank which because of some defect were void, the bank would have received money for which nothing of value was given in return. But such was not the case. The bonds were purchased by the bank with its own funds and this purchase and the subsequent sale to the plaintiff and the payment by the plaintiff of the purchase price taken alone was a valid transaction. It was only the repurchase agreement that was void for illegality.

This partial illegality of the transaction should not affect

the remaining portion. The petitioner purchased and received the bonds and paid therefor presumably the then market value thereof, and if she had so elected could have then sold the same without loss.

The rule stated in 6 Ruling Case Law 815 is as follows:

> "It is perfectly well settled that where one provision in a contract which does not constitute its main or essential feature or purpose, is void for illegality, or otherwise, but is clearly separable and severable from the other parts which are relied upon, such other parts are not affected by the invalid provision, and may be enforced as if no such provision had been incorporated into the contract."

To the same effect is *Western Union Telegraph Company* v. *Pennsylvania Co.*, 129 Fed. 849.

It is stated in Corpus Juris, Vol. 14a, at page 316, as follows:

> "Contracts by corporation may be valid in so far as it is within its power and void in so far as it transcends its power."

In *Illinois T. & S. Bk.* v. *Pacific Ry. Co.*, 117 Calif. 332, on page 343, it is said:

> "Granting that it was *ultra vires* of the Pacific Railway Company to mortgage the property of the cable railway company, it was still *intra vires* for it to borrow money and issue evidence of indebtedness; this is not disputed; consequently its bonds were not invalidated by the want of power to make the mortgage by which they were in terms secured."

Counsel for petitioner have cited a number of decisions in support of their position that the respondent is liable upon an implied assumpsit, but these cases do not involve transactions which were violative of public policy and specifically prohibited by law.

They have cited in this connection the two cases involving the Central Transportation Company and the Pull-

man Car Company, one reported at 139 U. S. 24 and the other at 171 U. S. 138. These two cases arose out of an *ultra vires* lease from the Central Transportation Company to the Pullman Car Company. The first suit was a suit started by the Central Transportation Company to recover rent under the lease. The second suit was a suit by the Pullman Car Company in which it sought to enjoin the Central Transportation Company from instituting further suits for rent under the lease, and in its bill of complaint it acknowledged that the leases were *ultra vires* and tendered a return of the property received under the lease, and offered to make compensation for such other property as could not be returned.

In the first case it was held that the lease was *ultra vires* because it was beyond the powers conferred upon the Central Transportation Company by the legislature, and that there could be no recovery on the contract. The court there indicated, however, that while refusing to maintain any action upon an unlawful contract the law would permit property or money parted with on the faith of the unlawful contract to be recovered back or compensation made for it, and in concluding the opinion the Court said on page 61:

> "The ground and the limits of the rule concerning the remedy, in the case of a contract *ultra vires*, which has been partly performed, and under which property has passed, can hardly be summed up better than they were by Mr. Justice Miller in a passage already quoted, where he said that the rule 'stands upon the broad ground that the contract itself is void, and that nothing which has been done under it, nor the action of the court, can infuse any vitality into it;' and that 'where the parties have so far acted under such a contract that they cannot be restored to their original condition, the court inquires if relief can be given independently of the contract, or whether it will refuse to interfere as the matter stands.' *Pennsylvania Railroad* v. *St. Louis & C. Railroad*, 118 U. S. 317."

It will be noted that it is left open for the court to determine apparently from the circumstances and the nature of the *ultra vires* act "whither it will interfere as the matter stands."

An examination of the opinion in the second case shows that the court recognized the distinction between *ultra vires* acts that were merely in excess of the power granted and acts that were contrary to public policy and prohibited by law. The court in 171 U. S. at page 149, refers to the first decision and states that therein "the contractor's lease was held to be unlawful and void because it was beyond the powers conferred upon the Central Transportation Company by the legislature and because it involved an abandonment by that company of its duty to the public. *It was added that there was strong ground also for holding that the contract between the parties was void because in unreasonable restraint of trade and therefore contrary to public policy.*"

It is therefore apparent that the holding of *ultra vires* was not based upon the contract being contrary to public policy, although there were strong grounds for such a finding. Later in the opinion, at page 151, the court says:

> "The principle of public policy is this: *ex dolo malo non oritur actio.* No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. The cases upholding this doctrine are numerous and emphatic. Indeed there is really no dispute concerning it. But the matter of controversy in this case is as to the extent to which the doctrine should be applied to the facts herein. * * * The right to a recovery of property transferred under an illegal contract is founded upon the implied promise to return or make compensation for it * * *. The right of recovery must rest upon a disaffirmance of the contract and it is permitted only because of the desire of the courts to do justice as far as possible to the party

> who has made payment or delivered property under a void agreement and which in justice he ought to recover, *but courts will not in such endeavor permit any recovery which will weaken the rule founded upon the principle of public policy already noticed.*"

Another case cited by petitioner is that of *Logan County National Bank* v. *Townsend*, 139 U. S. 67. This case was decided long before the 1929 amendment was added to the National Bank Act, and holds that where a bank buys stock under an *ultra vires* resale agreement that the seller may rescind the contract by tendering back the purchase price. But here again the court recognized the distinction between a power which is not expressly given to a bank and one which is expressly prohibited. With reference to this the court at page 71 says:

> "Probably according to a fair construction of the national bank act, the power is not expressly given to appellant to purchase and deal in bonds of the character in question; but neither is it expressly prohibited by the act to do so, and there is a proper and well recognized difference between 'the case of an engagement made by a corporation to do an act expressly prohibited by its charter or some other law and a case where legislative power to do the act has not been granted.'"

The case of *Aldrich* v. *Chemical National Bank*, 176 U. S. 618, permitted recovery for money borrowed and received by the bank through the unauthorized action of its vice-president, and the case of *Citizens' Central National Bank* v. *Appleton*, 216 U. S. 116, upheld a recovery from the bank of money actually received by the bank without any consideration other than a guaranty of the bank beyond the powers conferred. The recovery in neither of these cases was based upon the exercise by the bank of a power expressly prohibited. The case of *Coon* v. *Smith*,

4 Fed. Supp. 960, was a decision of the Federal District Court in Illinois and followed the first decision of the Illinois Appellate Court in the "*Awotin*" case, which was subsequently reversed by the decision now being reviewed.

B.

The purpose of the limitation restricting the sale of investment securities to sales made "without recourse" was the protection of the public at large from widespread bank failures as well as for the protection of the depositors and stockholders of the bank; this purpose would not be fulfilled by granting substantially the same relief under the common counts as is denied under the illegal contract.

As is pointed out in the case of *Knass* v. *Madison & Kedzie State Bank,* 354 Ill. 559, the serious danger arising from these repurchase agreements is the contingent liability to which the bank is subjected. Against this liability the bank is powerless to take the necessary steps for its protection. The maturing of these agreements at or about the same time by a large number of purchasers may bring about the complete destruction of the banking institution and prevent the performance of its functions as an agency of the federal government as well as great loss to depositors and stockholders who rightfully rely upon government inspections and regulations for their protection.

The purpose of the limitation of the National Bank Act restricting the sale of investment securities to sales "without recourse" is the prevention of this contingent liability and the protection of the public as well as of depositors and stockholders. This purpose would not be accomplished by the courts if they granted substantially the same relief under an implied contract as they denied under the illegal

contract. In the *Knass* case it is said that "the law does not prohibit and also enforce a contract."

The case of *Cassett, et al.* v. *First National Bank of West New York*, 168 Atl. 585, is a recent decision by the New Jersey Court of Errors and Appeals and is also reported in Volume 89 of American Law Reports Annofated, recently isued, at page 1302 (89 A. L. R. 1302). This case involved the right of a national bank to purchase stock in another corporation, and in that connection the Court considered the 1927 amendment to the National Bank Act. The Court held against such power. In its discussion of the issuse involved the Court gave attention to a question similar to the one here involved.

The Court there said (89 A. L. R. 1307):

> "This leads us to approve of the argument of the respondent, that, 'It is a contradiction in terms to say that a national bank which has no power whatsoever, under the law, to purchase speculative securities directly may, nevertheless, make itself liable as a purchaser, by acting as an agent, for a customer of the bank. Such a conclusion would nullify the purpose of the statutory limitation upon its powers, which is to conserve the rights of its depositors and stockholders and enable it to perform, unimpaired, its functions as an agency of the federal government.'"

The Court further says on page 1308:

> "Further, that persons dealing with national banks are charged with notice of their limitations, citing *McCormick* v. *Market National Bank*, 165 U. S. 538, 550, 17 S. Ct. 433, 41 L. Ed. 817, and *California Bank* v. *Kennedy, supra*. This also is undoubtedly so."

The opinion was concurred in by all fifteen judges participating in the hearing and a petition for writ of certiorari was denied by the Supreme Court of the United States on January 15, 1934. (291 U. S. 660.)

When the object to be accomplished is in violation of public policy the courts do not hesitate in denying relief even though the contract sought to be enforced is not illegal.

In *Henry H. Ingelsoll, et al.* v. *Coal Creek Coal Company, et al.*, 117 Tenn. 263 (98 S. W. 178), 9 L. R. A. 282, the Court at page 294 of L. R. A., says:

> "It is insisted that the contracts made are not illegal. This, we think, does not reach the root of the case, as the contracts themselves, abstractly considered, may be legal; and yet there may be circumstances surrounding their making which would deter the courts from enforcing them, or rights based on them, when all the facts are divulged and the nature of the consideration appears."

It is suggested by attorney for petitioner that the creation of such contingent liabilities is not necessarily dangerous, as the bank might protect itself by establishing "*a reserve against the maturity of such liability.*" The fact alone that transactions of this character would make necessary such a reserve is a sufficient inducement for the action taken by Congress. The necessity of placing the proceeds of all bonds so sold in a reserve fund awaiting the maturity of the bonds would hardly commend itself as good or safe banking. It would require that large sums of the bank's capitad remain tied up and unused for long periods of time, and make their eventual availability as assets of the bank dependent upon the value of investment securities at the date of their maturity. It would be speculating on future values with no chance of gain.

CONCLUSION.

We have by the foregoing brief presented our reasons for believing that the petitioner should not under the law recover in her action. We have shown that the transaction out of which her claim grows is void as being injurious to the public and prohibited by law; that the illegality affects only a portion of the transaction; that there is in the record no showing of any benefits derived by the respondent from the sale of the bonds involved; that the petitioner's claim, based solely upon an implied promise, and arising out of a transaction prohibited by law and against public policy, can give right to no enforcible obligation, and that to allow the relief sought would furnish a means for the undoing of the law prohibiting the repurchase agreement.

We therefore respectfully submit that the judgment of the Appellate Court of Illinois, First District, should be affirmed.

Respectfully submitted,

DANIEL M. HEALY,
Attorney for Respondent.